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Comment Letters
EFRAG
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Paris, 30 November 2023

Discussion Paper – Accounting for variable consideration from a purchaser's perspective

Dear Mr Klinz,

Mazars welcomes the opportunity to comment on EFRAG's Discussion Paper on Accounting for variable consideration from a purchaser's perspective.

We welcome the initiative taken by EFRAG to explore suggestions on when to recognise a liability for variable payments for asset purchases (in IAS 16 and IAS 38) since no consensus has emerged yet on this issue within the IFRS Interpretations Committee. We are pleased to contribute to this discussion. However we would like to point out that our present contribution is not the result of an extensive outreach nor expresses an interpretation of current IFRS. As a result, our preferences on possible directions for the evolution of IFRS Accounting Standards on these subjects may change over time as a result of new experiences or discussions with stakeholders.

We believe that currently standards address variable consideration differently for valid reasons. We would therefore favour a limited and pragmatic approach focusing on normal purchases of assets under IAS 16 and IAS 38. IFRS 16 raises specific issues (especially with regards to sale and leaseback transactions) which probably deserve a dedicated approach that is not addressed in this letter.

We are of the view that the existence of variable consideration should not affect the recognition criteria in an executory purchase contract and that, accordingly, a liability for the variable consideration part should be recognised as soon as the purchaser takes control of the goods or services.

With regard to the measurement of the variable consideration, we believe that the IFRS 15 guidance on the measurement of variable consideration could usefully be mirrored (excluding the constraint) to the purchase of an asset.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Edouard Fossat

mazars

Appendix

Discussion Paper Accounting for variable consideration
From a purchaser's perspective

Question 1 – When to recognise a liability for variable consideration

Chapter 2 explores two alternatives for requirements on when to recognise a financial liability for variable consideration that depends on the purchaser's future actions under IAS 32/IFRS 9:

a) Alternative 1: Recognising a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration. (The Discussion Paper includes suggested criteria on when a purchaser entity would not have the practical ability to avoid taking the action(s) that would trigger the variable consideration (see Question 2 below)).

b) Alternative 2: Recognising a liability when the purchaser performs the actions that trigger the variable consideration.

The Chapter also includes assessments of qualitative characteristics of useful information for each of the two alternatives. Do you agree with these assessments?

Do you think that other alternatives for requirements for liabilities for variable consideration than those listed should be considered? If so, please specify these other alternatives.

When do you think a purchaser should recognise a financial liability covered by IFRS 9 for variable consideration that would depend on the purchaser's future actions? Please explain your answer.

Are you aware of any issues relating to the measurement of a recognised financial liability for variable consideration? If so, please elaborate on these issues.

When to recognise a liability for variable consideration: exploring the alternatives proposed

1 We have a preference for Alternative 1, i.e. recognising a liability when the purchaser obtains control of the asset acquired. We believe that since a purchase is an executory contract, a liability should be recognised as soon as the purchaser takes control of the goods or services. With regard to the measurement of this variable consideration, we acknowledge that it is not addressed by IAS 16 or IAS 38. We believe it could be useful to consider the extent to which the IFRS 15 guidance on variable consideration could usefully be mirrored when accounting for a purchase (see also question 6).

2 We also believe such an approach would be consistent with IFRS 3.BC343-BC352 on contingent consideration: *Although the amount of the future payments the acquirer will make is conditional on future events, the obligation to make them if the specified future events occur is unconditional. Both boards concluded that obligations and rights associated with contingent consideration arrangements should be measured and recognised at their acquisition-date fair values. Failure to recognise that obligation or right at the acquisition date would not faithfully represent the economic consideration exchanged at that date. A contingent consideration arrangement is inherently part of the economic considerations in the negotiations between the buyer and seller.*

3 Conversely, IFRS 16 does not help in the analysis since both alternatives are considered in that standard. On the one hand, variable lease payments linked to future performance or use of an underlying asset are excluded from the measurement of lease liabilities (IFRS 16 BC168-169: *The IASB decided to exclude variable lease payments linked to future performance or use of an underlying asset from the measurement of lease liabilities*). On the other hand, referring to IFRIC Update, June 2020, Agenda Decision, 'Sale and Leaseback with Variable Payments (IFRS 16 Leases)', the seller-lessee recognises a liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. The initial measurement of the liability is a consequence of how the right-of-use asset is measured.

Sales-based or usage-based transaction

4 We consider that IFRS 15 is useful to assessing purchase contracts with variable consideration, and that this is also true for the exception made in IFRS 15.B63 where *an entity (seller) should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of Intellectual Property only when (or as) the subsequent sale or usage occurs (by the purchaser).*

5 In our view, this exception is relevant for the purchaser in a specific case of a variable consideration which is purely sales- or usage-based, i.e. no liability should be recognized (and consequently no additional cost for this variable consideration should be booked on the asset-side either). We would recommend for these cases that the purchaser should recognise costs incurred at the same pace as revenues are recognised in the buyer's financial statements. This would more faithfully depict the underlying "economics" and mirrors the IFRS 15 approach. We also believe that this approach could be applied on a broader scale than the one currently stated in IFRS 15.B63, i.e. it could be applied not only to the sale/purchase of intellectual property but also to the sale/purchase of other intangibles and tangible assets.

Question 2 – How to assess that an entity has no practical ability to avoid taking an action

Chapter 2 suggests five alternative criteria for assessing when a purchaser would have no practical ability to avoid taking an action which would trigger a variable consideration (when the purchaser is not legally or constructively obliged to perform the future actions). The five suggested criteria are:

a) When avoiding taking an action would mean that the purchaser would have to cease its activities.

b) When avoiding taking an action would have a significant unfavourable economic impact on the entity.

c) When avoiding taking an action would have a significant unfavourable economic impact in the context of the acquired asset.

d) When avoiding taking an action would result in using an acquired asset in a manner that would not reflect the economic purpose of acquiring the asset.

e) When avoiding taking an action would have marginal economically unfavourable consequences for the entity.

Do you agree that the above criteria are valid for assessing whether a purchaser would not have the practical ability to avoid performing a future action that would trigger variable consideration?

Are there other criteria that should be considered? If so, please elaborate on these other criteria.

Which of the above criterion/criteria would you prefer and why?

Criteria to define no practical ability?

6 We believe that the situations described in this question regarding the practical ability to avoid taking an action are not necessary for accounting purposes.

7 In fact some extreme situations contemplated (non-going concern assumption) are already to be considered at initial recognition and do not deserve additional standard-setting. We believe that the other situations impact the estimate and should already considered as part of the measurement (see question 3).

Question 3 – Interpretations of the definition of cost

Chapter 3 notes that the definition of 'cost' included in IAS 16, IAS 38 and IAS 40 ("the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, e.g., IFRS 2 Share-based Payment") is interpreted differently.

How do you interpret current requirements in relation to whether/when the measurement at cost of an asset covered by IAS 16 or IAS 38 should be updated to reflect changes in estimates of variable consideration?

How do you think 'cost' should be defined to provide the most useful information and do you think it is useful to consider that measurement at cost should be similar across all IFRS Standards?

Definition of costs

8 We would favour considering the IFRS 15 guidance on variable consideration (excluding the constraint) when estimating the cost of the variable part of a purchase. According to this guidance (IFRS 15.53) the entity would estimate the amount of variable consideration considering two possible methods:

- the expected value (i.e. the sum of probability weighted amounts in a range of possible consideration amounts), or
- the most likely amount (i.e. single most likely amount in a range of possible considerations amounts).

9 Both methods are also described in IAS 37.39 and .40 respectively to provide the best estimate on a provision. In our view, both methods would adequately reflect the economic value of the asset. The resulting estimated cost of the variable consideration would be:

- included in the initial value of the purchased asset, and
- updated only if and when necessary (for reassessment at the end of each reporting period).

10 We believe that the single most likely method is less burdensome for preparers than the expected value approach, because the latter would probably require a more frequent re-assessment at the end of a reporting period.

11 As mentioned previously (see Question 1) mirroring IFRS 15, for usage or sales-based variable consideration the initial expected cost of the variable component would be nil and then recognized as incurred.

IFRS Question 4 – Possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration

Chapter 3 explores the following three possible alternatives for requirements for when the cost of an asset should be updated in situations where the asset is acquired in exchange for variable consideration in cash or another financial instrument:

a) Alternative 1: Not updating the cost estimate.

b) Alternative 2: Updating the cost to reflect all subsequent changes in estimates of variable consideration.

c) Alternative 3: Sometimes updating the cost of an asset. The Discussion Paper lists the following criteria which could be used to determine when the cost of the asset should be updated. One or several of the criteria could be used:

• Update if estimates of variable consideration are included in the measurement of the asset's cost at initial recognition.

• Update if the change in estimates of variable consideration takes place before the asset is ready for its intended use.

• Update the cost to the extent that variable payments are associated with future economic benefits to be derived from the asset.

• Update the cost to the extent that variable consideration is linked to the initial quality of the asset.

Do you think that other possible requirements than those explored in the Discussion Paper should be considered?

If so, what are these other requirements?

Chapter 3 presents the qualitative characteristics of useful information for the three possible alternative requirements (including the four different criteria under Alternative 3) for when measurement at cost should be updated to reflect changes in estimates of variable consideration. Do you agree with the assessed characteristics of useful information for the alternatives? If not, which elements should be considered and which assessments do you disagree with?

When do you think 'cost' should be updated to reflect changes in estimates of variable consideration? If you think that 'cost' should sometimes be updated, under what circumstances should it be updated?

12 As stated in Question 3, we consider that the variable consideration needs to be updated only upon changes in the estimate of the costs.

13 In that regard, we believe that Alternative 3 is the most appropriate. This is because on the one hand we support consistency with IFRIC 1 in that the asset value should partly reflect changes in the liability. On the other hand, we consider that not all changes in the expected value should be reflected in the asset's measurement.

14 Variable consideration generally reflects the sharing of risks and rewards between the seller and the purchaser.

15 In our opinion, a change in the amount of a liability due to a mere change in discounting assumptions or an event outside the control of either the seller or the buyer would less likely deserve being reflected

in the asset value because it does not intrinsically change the originally agreed amount of the asset value (i.e. we would rather see such changes in a liability recorded in the income statement).

16 Conversely a change in the liability due to the performance or quality of the asset (i.e. due to the actual performance of the asset turning out to be better or worse than initially expected), would more likely reflect a change in the initially agreed balance of risks and rewards between the parties and therefore more likely adjust the cost of the asset in accordance with IFRIC 1.

Question 5 – General requirements on accounting for variable consideration

Chapter 4 complements Chapters 2 and 3 of the Discussion Paper by assessing the broader requirements for accounting for variable consideration. Chapter 4 examines the advantages and disadvantages of respectively developing a unified set of principles for IFRS requirements to account for variable consideration and undertaking Standard-by-Standard amendments that could apply to the two issues covered in Chapters 2 and 3 (i.e., liability recognition when payment depends on purchaser's future actions and measurement of the acquired asset).

Do you agree with the advantages and disadvantages identified?

Based on your assessment and the outlined advantages and disadvantages of respectively developing a unified set of principles for IFRS requirements to account for variable consideration and undertaking a Standard-by-Standard amendment, which of the standard-setting responses do you support?

Do you think that requirements to deal with the issues mentioned in Chapters 2 and 3 should be based on a unified set of principles for how to account for variable consideration?

17 We believe that standards address variable consideration differently for valid reasons and we would favour a limited and pragmatic approach focusing on normal purchases of assets under IAS 16 and IAS 38 with dedicated paragraphs on variable consideration.

Question 6 – Applying an IFRS15 mirroring approach

Chapter 4 notes that requirements on variable consideration included in IFRS 15, could be 'mirrored' to provide guidance on how to account for a liability for variable consideration (with the exception of the constraint to only include in the transaction price the amount of variable consideration that is highly probable not to result in a significant reversal in the amount of cumulative revenue recognised).

Do you think such an approach would result in useful information? Please explain why or why not? future periods, by providing further specifications and breakdown of the expenses of a period?

18 As mentioned and explained in the previous questions, we believe that the IFRS 15 requirements on variable consideration could be mirrored (with the exception of the constraint to only include in the transaction price the amount of variable consideration that is highly probable not to result in a significant reversal in the amount of cumulative revenue recognised). They provide a consistent and pragmatic guidance to estimate the costs of the variable consideration in a normal purchase under IAS 16 and IAS 38.